UNITED
NATIONS

TD

United Nations
Conference
on Trade and
Development

Distr.
GENERAL

TD/B/COM.2/EM.2/2
7 July 1997

Original : ENGLISH

TRADE AND DEVELOPMENT BOARD
Commission on Investment, Technology
and Related Financial Issues
Expert Meeting on Investment Promotion
and Development Objectives
Geneva, 24-26 September 1997
Item 3 of the provisional agenda

INVESTMENT PROMOTION AND SUGGESTED MEASURES TO FURTHER DEVELOPMENT OBJECTIVES

Investment promotion and development: issues and questions

Report by the UNCTAD secretariat

CONTENTS

		Paragraphs
Introduction		1 - 6
I.	Promotion of inward foreign direct investment	7 - 41
II.	Promotion of outward foreign direct investment	42 - 50
III.	Investment incentives	51 - 62

GE.97-51289

INTRODUCTION

1. At its ninth session, United Nations Conference on Trade and Development recognized that foreign investment can contribute to the strengthening of the production bases and export capacities of developing countries and help in their integration into the multilateral trading system and the world economy. In order to attract FDI, countries were invited to continue initiatives in such areas as a stable macroeconomic environment, transparent and accountable public administration, respect for property rights and the rule of law, the quality of labour, improvement of infrastructure, entrepreneurial and institutional capabilities and simplified administrative and regulatory frameworks. In parallel to those efforts, all countries were invited to pursue policies enabling FDI and to consider, and where possible improve, measures that facilitate FDI flows to developing countries.

2. The Conference also decided that UNCTAD should focus, inter alia, on the issue of promoting opportunities for FDI in host countries by facilitating the exchange of experiences on investment promotion and the benefits of FDI.

3. Subsequently, the Commission on Investment, Technology and Related Financial Issues at its first session (November 1996 and January 1997), decided to convene "an expert meeting on investment promotion and suggested measures in this respect that further development objectives". This paper presents a brief background on the subject, and poses issues and questions for discussion by the expert meeting.

4. The paper considers both inward and outward investment promotion. While the focus of most investment promotion efforts are on attracting FDI, the promotion of outward investment has become more prominent in recent years. In addition, regional organizations promote investment into their region, taking into account the differing levels of development of their member states, and they promote outward investment to other regions.

5. The paper also considers the role of incentives in investment promotion.Many governments offer incentives to investors, though their costs and benefits are not easily calculated and evidence suggests that they are not of fundamental importance in influencing investment decisions.[1] There further appears to be a tendency for public authorities to compete among themselves to attract large-sized investments by offering extravagant incentive packages.

6. Most developing countries, specially the least developed among them, do not have the large or dynamic markets, skill or productivity/wage ratios favoured by foreign investors. Investment promotion, therefore, must be seen in the context of larger development efforts.

---

[1] For a more complete discussion of the issues, see UNCTAD, Incentives and Foreign Direct Investment, (United Nations Publication, Sales No. E.96.II.A.6, 1996).

I. PROMOTION OF INWARD FOREIGN DIRECT INVESTMENT

7. Investment promotion reflects the growing competition for FDI. Over the past decade, many countries, particularly developing countries and economies in transition, have liberalised the policy environment and legal framework in favour of foreign direct investment. Although worldwide FDI flows have quadrupled, including to developing regions, much of it is concentrated in a small number of countries. For many governments, the level of FDI inflows does not meet expectations. With investment policy regimes becoming increasingly open and similar, countries find that they need to undertake additional promotional efforts to attract the desired level of inflows, and of a kind consonant with their development objectives.

8. National policy and legal frameworks broadly delineate the enabling environment for foreign investors. They set conditions, if any, with respect to: entry and establishment; ownership and control requirements; sectoral restrictions; authorisation and reporting; and operations (including performance requirements, licenses, personnel requirements). They also provide basic protection to foreign investors, such as: national treatment; fair and equitable treatment; legal protection and guarantees (e.g., expropriation); transfer of funds and repatriation of profits and capital invested; transparency; and recourse to international means for the settlement of disputes.

9. Additional regulations that may govern foreign investors include: competition policy (including restrictive business practices); accounting and reporting; consumer protection; environmental protection; and labour, quality and safety standards.

10. The general trend in national laws and policies is one of liberalisation and convergence in the treatment of foreign investors, including with respect to: right of establishment; national treatment; protection against nationalisation; international dispute settlement; and assurances for the repatriation of earnings and capital. This general trend is complemented by the rise in bilateral investment treaties.[2] There is a growing number of treaties between countries which exempt foreign investors from double-taxation. The number of countries that are signatories to international instruments (such as the Multilateral Investment Guarantee Agreement) has also increased and is expected to continue to increase.

11. The liberalisation trend is illustrated in table 1. In 1996, there were 138 national regulatory changes of which 122 were in the direction of liberalisation (e.g., more liberal operational conditions, 35 instances; more liberal foreign ownership, 9; more liberal approvals, 9; more guarantees, 6; and less control, 5 instances) or in the direction of promotion (e.g., more incentives of which there were 47 instances).

---

[2] There are more than 1,300 bilateral investment treaties, most of which were signed in the current decade. For a recent analysis, see UNCTAD, "Bilateral investment treaties and their relevance to a possible multilateral framework on investment: issues and questions", TD/B/COM.2/EM.1/2, 21 March 1997.

Table 1. National regulatory changes, 1991 - 1996
(Number)

Item	1991	1992	1993	1994	1995	1996
Number of countries that introduced changes in their investment regimes	35	43	57	49	64	65
Number of changes	82	79	102	110	112	138
Of which: In the direction of liberalisation	80	79	101	108	106	122
or promotion Of which: More incentives	..	24	23	30	35	47

Source: UNCTAD, World Investment Report 1997: Transnational Corporations, Market Structure and Competition (United Nations Sales Publication, forthcoming), chapter I.

12. The liberalization of FDI regimes does not immediately evoke an investo response, for several reasons. First, there are information and communication lag to be overcome before foreign investors come to know of, and understand, regulator changes. Second, investors react to actual changes in the business environment, no policy pronouncements, and it often takes time before regulatory changes ar accompanied by corresponding changes in administrative procedures and practices.

13. Third, investment decisions are based as much on the expected stability o policies over the full term of the investment, as on the actual policy stance. Ther is thus a "wait and see" attitude, and paradoxically, the more dramatic is th policy change, the longer can be the lag. Fourth, liberal regimes are today take for granted: with so many countries liberalising, a "so what" attitude is a commo investor response; even more so than before, liberalization is a necessary but no sufficient condition for investment.

14. In order to increase investor response, governments adopt a broad range o promotional measures. These include information and media campaigns to overcome market failures due to information and communication; the establishment of "one-stop" institutions to lower transaction costs arising from cumbersome administrative practices; and the offering of a variety of fiscal and financial incentives to compensate for non-business risks (e.g., policy changes) and uncertainty (e.g., unfamiliar country context).

15. Investment promotion can be costly and yield little immediate result. While failure is easily measured, success is less so. For example, when FDI inflows increase, it is unclear how much inflow would have occurred in any event. In the case of extravagant incentive packages, it is also possible that the added cost outweighs the benefits. How much FDI, and what price, are key issues that should not be lost sight of in devising investment promotion measures.

16. Investment promotion strategies focus on three main elements: the country, the investor and the investment. Taken in turn, the three strategic considerations are:

(a) What are the country's key locational advantages as a site for foreign investment and how can these advantages be best marketed?

(b) Which investors are likely to be attracted to such a site and how can they be best targeted?

(c) What are the steps in undertaking an investment -- from plans to operations -- and how can these steps be facilitated so that potential investors do not lose interest?

A. Marketing locational advantages

17. The creation of a positive image of the host country to investors is considered the first step in investment promotion. This sometimes means changing a country's negative image as a location for foreign investment, stemming from earlier inhospitable policies or events (such as war or famine). National image is also shaped by that of the region.

18. Image-building is often seen as a public relations activity. Considerable effort is allocated to advertising; the holding of exhibitions; and goodwill missions led by officials whose tenure can be short-lived. But image-building is more than that.

19. If a country was previously restrictive of foreign investment, it is important to develop a welcoming attitude on the part of government officials and institutions, the local business sector and the public at large. In other words, image-building must first begin at home before it can succeed abroad. An elaborate worldwide public relations campaign can bring business executives into a country, only to have them turn back due to an unwelcoming attitude on the part of a single customs official. Training of officials, institutional and market reforms, public-private sector dialogues and general information activities carried out over a sustained period, are necessary for inculcating a welcoming attitude towards foreign investment.

20. If a country has a volatile political system, it is important that foreign investment be subject to non-partisan consensus. Governments may come and go, but policies should not.

21. If a country is poor and underdeveloped, it is important to focus on long-term potentials and relate these to current investment opportunities. A large population is both a source of abundant labour and a future market (which is ranked by investors as the most important locational advantage a country can offer, see fig.1). A small population need not mean a small market in a regional context or as an export platform, but it may mean allocating greater priority to education and training than other countries. Weak infrastructure is an impediment to investment in manufacturing but it can also be an attractive opportunity for the international

infrastructure industry. All countries have specific locational advantages of some kind that can be developed and marketed.

22. Finally, attention should be given to the image-building of Africa. International investors rank future investment opportunities in Africa far lower than elsewhere (see figure 2), even though actual rates of return on existing investments in Africa compare more favourably to those in other regions.[3] In this respect, recent commitments to strengthen home-country investment promotion programmes for Africa are a welcome step.

B. Targeting investors

23. The more successful investment promotion programmes target specific types of investors. Targeting helps in several ways:

(a) To take due account of overall national objectives for FDI (e.g., priorities for specific sectors, industries and/or sub-regions);

(b) To identify potential investors who are most likely to be attracted by the locational advantages which the country has to offer;

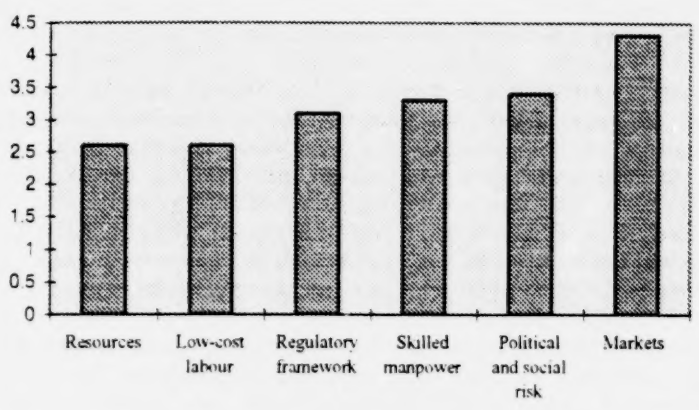
(c) To fine-tune promotion efforts to the interests of specific investor groups;

(d) To economize in the use of limited investment promotion budgets.

---

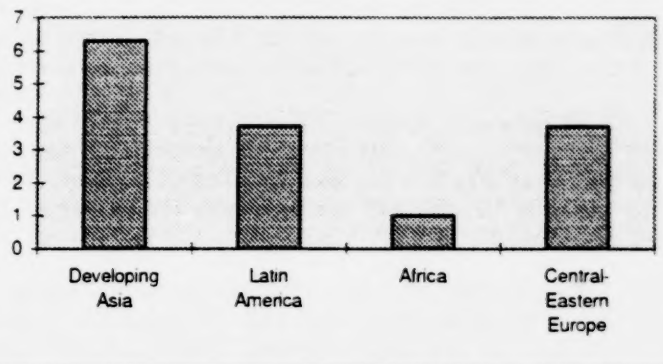
[3] For evidence on rates of return see UNCTAD, Foreign Direct Investment in Africa, Current Studies, Series. A, No 28.

Figure 1. Investor ranking of locational advantages



Ranking from 0= not important to 5=very important

Figure 2. Investor ranking of future investment opportunities



Ranking from 0 to 10= top priority

Source: International Investment: Towards the Year 2001, United Nations, 1997 Sales No. GV.E.97.05.

24. There are some 40,000 transnational corporations: where does one start? To begin with, one should look at companies and home countries who are already investing in the host country: are they reinvesting earnings? could they invest more? could they upgrade into more value-added activities? Next, one could look at the types of FDI entering other host countries with similar locational advantages: why are they investing there and not here? Answers to such questions provide feedback on the effectiveness of investment policies and procedures, and where their functioning can be improved to reach best practices.

25. Regional investors are another important category, particularly in Asia and Latin America where intra-regional flows account for a significant and growing share of FDI. Nearly 40 per cent of the FDI stock in developing Asia originates from Asian developing countries. During the 1990s, intraregional FDI in Latin America was about U.S.$7 billion, with most of the outflows originating from Chile, Brazil and Argentina. When it comes to South-South investment, the focus should be on small and medium-size foreign investors, who often have different needs from those of traditional home countries. Included in this investor category are expatriates.

26. More aggressive targeting strategies focus on footloose industries and sunset industries. Footloose industries are not location dependent (either resources or markets) and are usually export-oriented. Firms in these industries locate strategically, according to where they can secure a competitive advantage vis-a-vis other firms in specific regional or global markets. For example, textile manufacturers may locate facilities in countries with special trade privileges to otherwise closed third-country markets. A few countries have developed successful investment promotion strategies by positioning themselves as gateways to regional markets. Many other countries have established export processing zones to attract footloose industries, with mixed success.

27. Sunset industries face slowing sales in mature markets and growing sales in world markets. While firms in these industries do not necessarily relocate plants, they do expand operations globally through FDI, which is typically market-seeking. Such firms, with long-term corporate strategies to expand abroad, are therefore suitable targets for investment promotion, particularly by large host countries.

28. Developing countries with small markets are likely to be more successful in targeting intra-industry activities, particularly component manufacturing. The spread of integrated international production has also created functional niches for developing countries in fields such as accounting, data processing and the programming of software applications.

29. Regional groupings, such as ASEAN, have collectively targeted complementary intra industry activities. For example, in the automobile industry, engine manufacturing has been located in one country and transmission manufacturing in another. Such complementation schemes have been implemented on a brand-to-brand basis, targeted at specific companies at a subregional level. A similar strategy had been pursued in Latin America with little success but, with the growing importance of integrated international production as a corporate strategy, it may warrant a second look.

30. Yet another approach is to identify gaps in domestic industries, and to target foreign firms which could complement domestic firms through backward and forward linkages, thereby strengthening national technological capabilities and production capacities.

31. To sum up, targeting involves a number of choices revolving around industries, firms and activities, and home countries. It requires extensive research to identify firms that are likely candidates to invest in the country, and ways in which those investments can be made to meet investor needs and development objectives.

32. An UNCTAD 1996 survey of 80 investment promotion agencies (IPAs) wordwide shows that 73 per cent of the IPAs have a system of some sort for identifying and attracting investors, and assessing their economic and financial strengths. Only 28 per cent of the IPAs in developing countries have computerized systems with access to electronic databases abroad, while 53 per cent of the IPAs from developed countries do.

33. Roughly half of the surveyed IPAs conduct feasibility studies. Fea ibility studies can be useful to the extent that they provide all relevant information that investors may be interested in. But they are expensive and take time to prepare, and need to be regularly updated as economic and business conditions change. In any event, foreign investors often rely on their own calculations.

C. Facilitating investment

34. Most countries have investment promotion agencies. There are some 100 members of the World Association of Investment Promotion Agencies (WAIPA), which was established in 1995 for the purpose of exchange of best practices in investment promotion. Generally, IPAs are part of the public sector and sub-subordinated to a ministry, but IPAs can also be autonomous government agencies, joint ventures (between the government and private sector) or entirely private.

35. An IPA's tasks are wide-ranging. First, an IPA typically carries out the various activities that give effect to image-building and investment promotion campaigns, such as: distribution of promotional brochures, advertising in world media, participation in investment forums and the like. Second, an IPA usually also undertakes activities related to investor targeting, including: identifying potential investors; preparing investment profiles and feasibility studies; making direct contact with prospective investors and bringing to bear all kinds of marketing and selling skills to generate an investment. The more established IPAs maintain offices abroad for the purpose of directly generating investment.

36. Third, an IPA may act as a "one-stop" agency to assist investors in the start-up period of the investment. The entry of foreign investment is sometimes subject to a screening, approval and registration process. While it need not be cumbersome or time-consuming, it often is in practice, especially for first-time investors and smaller firms. Many countries have streamlined the process considerably, but even minor institutional bottlenecks at the entry level can negate an otherwise overall attractive policy and legislative investment climate. To facilitate the process, an IPA may assist an investor in satisfying the investment criteria and thereafter coordinate the grant of the necessary permits and approvals by the various other government agencies concerned. To the extent that an IPA adds value to the start-up process, by speeding the general paperwork, investors are frequently receptive to paying for the facilitation service.

37. Fourth, an IPA may offer a number of convenience services to investors after the investment has been approved. For example, an IPA may, for a fee, assist in securing telephone, electricity, water and sewage connections. In fact, full recovery of infrastructure costs is possible in well-designed industrial zones. Apart from earning revenue, investment services project a welcoming attitude and allow investors to operate on equal terms with domestic enterprises. Moreover, satisfied investors not only reinvest, they also can be the best ambassadors for promoting the country to new investors.

38. Many of these tasks call for skills not readily available in the public sector. For example, effective investment promotion calls for skills in marketing; while efficient investment services require a business background. Governments may underestimate the importance of such skills, specially when IPAs are offshoots of government departments staffed with persons with an administrative rather than a specialist background.

39. Of the several IPA functions, investment services and facilitation are the most important. They convert investor intentions into actual investment and ensure continued satisfaction through the life of the investment ("aftercare").

D. Questions

40. Questions that may deserve discussion are:

(a) Are the long-term developmental benefits of FDI enhanced by targeting or is the market a better means of allocating FDI among sectors?

(b) How can home-country programmes for disseminating information and support services to their investors be improved?

(c) What is the regional experience in investment promotion and targeting?

(d) Special economic zones, mainly export-processing zones, industrial districts and science parks, have proliferated around the world: there are more than 800. How effective are they in attracting FDI?

(e) What is the experience in involving the host-country business community in targeting foreign investors?

41. With regard to IPAs, additional questions that may deserve discussion are:

(a) How effective are the various tools of the trade: advertising and media campaigns; project profiles and feasibility studies; investment forums and missions; making direct contact with specific investors or groups; facilitation and aftercare?

(b) The UNCTAD survey indicates that 82 per cent of the IPAs assist investors in obtaining start-up permits and licences. At the same time, 55 per cent of the IPAs are also engaged in screening activities. In 28 per cent of the

countries, screening of investment is performed by another government agency. Can IPAs screen investment and also facilitate it?

(c) Are IPAs more effective when located inside or outside the government structure?

(d) What is the experience with revenue-generating services and other self-financing mechanisms?

(e) Can IPAs facilitate FDI linkages with local suppliers?

II. PROMOTION OF OUTWARD FOREIGN DIRECT INVESTMENT

42. The promotion of outward direct investment has been the traditional domain of developed countries, but in recent years a number of developing countries and economies in transition have also begun to promote the outward investment of their enterprises. They do so for reasons of improving access to overseas markets, resources and technologies.[4]

43. All of the OECD countries promote outward FDI, primarily in three areas: information and technical assistance; financial support and fiscal incentives; and investment insurance (see table 2).

---

[4] For a fuller discussion of the reasons, see UNCTAD, World Investment Report 1995: Transnational Corporations and Competitiveness (United Nations Publication, Sales No. E.95.II.A.9), chap. VII.

Table 2

Outward FDI promotion programmes of OECD member countries, early 1990s

	Information and technical assistance					Financing		Insurance
Country	Information	Matchmaking	Missions	Feasibility studies	Project development and start-up	Equity	Loans	Guarantees
Australia	•	•	•	•				
Austria	•					•	•	•
Belgium	•	•				•	•	•
Canada	•	•	•	•	•	•		
Denmark						•	•	•
Finland	•		•	•	•	•	•	•
France	•			•	•	•	•	
Germany	•	•	•	•	•	•	•	•
Italy	•	•	•	•	•	•	•	•
Japan	•	•	•	•	•	•	•	•
Netherlands	•	•	•	•		•	•	•
New Zealand	•	•		•		•		
Norway	•	•	•	•	•		•	•
Portugal	•	•	•				•	
Spain	•	•	•			•	•	•
Sweden	•	•		•		•	•	
Switzerland	•	•	•	•	•	•	•	•
United Kingdom						•	•	•
United States	•	•	•	•	•		•	•

Source: OECD, Promoting Foreign Direct Investment in Developing Countries (Paris: OECD, 1993).

44. The most common form of outward promotion, among developed and developing countries, is the provision of information and technical assistance. Information is disseminated through publications, seminars, teleconferences, trade fairs and the fielding (and hosting) of investment missions. Technical assistance consists primarily of partial support for feasibility studies and also some start-up support, particularly for smaller or less experienced investors. Start-up support can include assistance in preparing legal documents, adapting technology to local conditions and training of host country managers and employees.

45. Financial support is provided in about a half of the OECD countries through a development finance institution, of some type, that combines assistance to developing countries with support, usually loan, equity or co-financing, for private FDI projects. The European Union offers a regional approach to FDI-related development assistance. In addition, some developing countries, including the Republic of Korea, India, Singapore, Thailand, Malaysia and Taiwan Province of China, provide direct financial support, and in some cases also fiscal incentives, to promote desired outward FDI.

46. National investment insurance programmes exist in most developed countries to provide coverage for expropriation, war and repatriation risks. Many of the programmes require that the FDI being insured generates economic benefits such as increased jobs or revenue for the home country or serves other national interests. Similar insurance programmes exist in developing countries, but they are of lesser importance. The need for national insurance is alleviated by the establishment of the MIGA in 1985.

47. Most developing countries do not promote outward FDI. Perhaps the obvious reason is that the need to do so is low. The number of transnational corporations based in developing countries, while significant and growing, is still relatively small. The vast majority of enterprises produce for the domestic market and service world markets through exports (this is true for all countries but specially developing economies). Thus, there is little demand for promotional measures. However, the demand could be latent, as many developing countries have had, until recently, restrictive regulatory policies to keep investment funds at home. Countries with foreign exchange constraints face a policy dilemma in the liberalization of outward FDI.

48. Nevertheless, even when regulatory and policy regimes are neutral vis-a-vis outward FDI, as is increasingly the case in developing countries and economies in transition, the need for promotional measures should still be queried. Promotional measures can introduce market distortions and encourage enterprises to prematurely expand production overseas, before they have mastered the basic technological capabilities necessary for successful outward FDI. For example, an enterprise's competence in production may be high, but weak in other areas such as product design and marketing, and working with suppliers (all of which are important for succeeding in the more developed market economies). Even large enterprises may experience such problems, as illustrated by the experience of Korean firms, some of which divested their early investments in the United States and moved facilities to other host countries with business conditions similar to their own, such as Mexico. There are other instances where firms have channelled earnings into outward FDI instead of upgrading domestic plants, only to discover that they were locked into vintage

technologies (and low-wage, low value-added production), and no longer competitive with rival firms in their own markets.

49. In short, the strategic considerations of enterprises in developing countries may not coincide with those of firms in developed countries as it concerns outward FDI. Singapore's policy favours outward FDI within Asia, partly because Singaporean firms looking to invest overseas for the first-time may find it easier to initially regionalize, before going global.

50. Questions that may deserve discussion are:

(a) How effective are the various types of outward investment promotion activities - information, technical assistance, finance, insurance?

(b) In many countries, the promotion of outward investment is often the concern of more than one national institution. Is there a case for a "one-stop" agency for outward investment?

(c) Should there be greater cooperation between inward and outward investment promotion agencies?

III. INVESTMENT INCENTIVES

51. Governments offer incentives to attract FDI, to steer it into favoured industries or regions, or to influence its character, for example, when technology-intensive investment is being sought. There are three types:

(a) Fiscal incentives reduce the tax burden for a foreign investor. The most common are tax holidays; but they can include reduced rates on taxes of all kinds, including import duties.

(b) Financial incentives provide finance for new investment or to defray capital or operation costs. The most common types include government grants, subsidized credit, government equity participation and insurance at preferential rates.

(c) Other incentives include training of local employees; dedicated infrastructure; certain subsidized services; market preferences; and preferential treatment on foreign exchange.

52. The range of incentives to FDI, and the number of countries that offer incentives, have increased considerably in the past decade. The manufacturing sector is still the main focus of incentives, though some governments continue to target agriculture, fisheries, mining and oil exploration and extraction, hotels and tourism. Increasingly, countries target investment in industries involving technology and high value-added (such as electronics, robotics, computer software) and in infrastructure projects. Some countries also offer incentives to encourage companies to locate specific corporate functions within their territories, for example, to set up regional headquarters.

53. In general, developed countries rely more on financial than fiscal incentives (partly because the latter involve parliamentary decision), while developing countries rely more on fiscal incentives (mainly because they lack the resources to provide financial incentives).

54. Among fiscal incentives, developed countries appear to prefer accelerated depreciation and specific deductions for corporate income-tax purposes. In developing countries, tax holidays, exemptions from import duties and duty drawbacks are more prominent. Tax holidays are typically available for up to 5 years after an investment, but they can go up to 10 years and, occasionally, 25 years. Tariff concessions are granted for periods usually lasting 5 to 10 years, but sometimes as long as 15 to 25 years for major projects.

55. Financial incentives in developing countries are mainly subsidized loans, loan guarantees and government grants. For example, the package of financial incentives offered to foreign investors in some low-income countries may include: grants for labour training during the first year of a manufacturing investment; loan guarantees from international line of credit sources; government equity participation when required; up to 10 per cent annual wage subsidies; and up to 15 per cent rebates on the cost of electricity, water and sewage services on factory premises.

56. Finally, the number and range of other incentives has increased considerably in recent years. Subsidized infrastructure and services are often provided for enterprises investing in export-processing zones, enterprise zones or science parks. In addition, the provision of information, consultancy and management services, as well as training and other technical assistance at subsidized prices or no cost are a common form of incentive in many countries, often aimed at small firms, technology transfer or underdeveloped regions.

57. In developing countries, the rationale for investment incentives is to compensate for the failure of host country markets to provide sufficiently attractive rates of return that fully capture the various benefits of FDI. These benefits include capital and jobs, and also longer-term gains such as transfer of technology and managerial know-how, upgrading of worker skills and access to world markets through intra-firm trading networks. In addition, individual investments can lead to sequential investments by the same investor or associated investment by other firms thus creating agglomeration effects.

58. However, in all these cases, it is clearly not in the public interest that the amount granted in incentives exceed the value of the benefits to the public. Recent examples suggest that incentive packages can be extravagant in the automobile and electronics industries.[5]

59. Experience also suggests that the capacity to execute incentives measures effectively varies widely among countries, because of pressures for incentives to be higher than warranted or because administrative capacities are not sufficient to implement and monitor incentives efficiently.

---

[5] For examples, see UNCTAD, Incentives and Foreign Direct Investment (United Nations Publication, Sales No. E.96.II.A.6, 1996).

60. Finally, and more generally, care has to be taken that incentives are offered on the basis of host country needs, and not simply to match incentives offered by other countries. A public authority that is well financed is clearly more likely to win a bidding contest for an investment project than one that is not well financed. In competition for FDI, poorer countries are relatively disadvantaged.

61. Given the dilemma inherent in the competition for FDI -- whereby countries tend to overbid through investment incentives -- governments would collectively maximize welfare by cooperatively agreeing in principle to limit the amount of incentives offered. In any event, more restraint should be exercised by countries that do not need to resort to incentives to attract FDI.

62. Questions that may deserve discussion are:

(a) Survey data show that monetary incentives are a relatively minor factor in the locational decisions of foreign investors relative to other locational advantages, such as market size and growth, production costs, skill levels, political and economic stability and the regulatory framework. How effective are incentives compared to other promotional activities?

(b) Are incentives offered on the basis of careful cost-benefit analysis or simply to match what other countries offer?

(c) When countries are at the same level of development, and one country offers incentives and another does not, foreign investors could be influenced in their locational choices between countries. Is such competition a fact of life or would countries be better off competing on fundamentals?

(d) Investors frequently ask for discretionary incentives and governments often oblige. Is it more effective to offer a general incentives package or to negotiate deals responding to the particular conditions of individual investments?

(e) Is there a role for international cooperation in encouraging greater transparency in the granting of investment incentives?